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January 22, 1998

BY HAND DELIVERY

CC 98-5

Ms. Magalie R. Salas
Secretary
Federal Communications Commission
Room 222
1919 M Street, N.W.
Washington, D.C. 20554

Re: Petition of LCI International Telecom Corp. For Expedited Declaratory Rulings

Dear Ms. Salas:

Enclosed for filing are the original and four copies of the "Petition of LCI International Telecom Corp. For Expedited Declaratory Rulings."

Please return a date-stamped copy of the enclosed (copy provided).

Please contact the undersigned if you have any questions.

Respectfully submitted,

Peter A. Rohrbach
Counsel for LCI International Telecom Corp.

Enclosures

cc: ITS

RECEIVED

JAN 2 2 1998

Federal Communications Commission
Office of Secretary

Before the
FEDERAL COMMUNICATIONS COMMISSION
Washington, DC 20554

In the Matter of:

Petition for Expedited
Declaratory Rulings

PETITION OF LCI INTERNATIONAL TELECOM CORP.
FOR EXPEDITED DECLARATORY RULINGS

A "Fast Track" Plan To Expedite Residential Local Competition And Section 271 Entry Through Establishment Of Independent RBOC Wholesale And Retail Service Companies

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INTRODUCTION AND EXECUTIVE SUMMARY

This petition (along with companion petitions to be filed in New York and Illinois) is aimed at breaking the current stalemate that is denying consumers -- and especially residential consumers -- the benefits of the Telecommunications Act of 1996 (the Act). Congress intended to open "all telecommunications markets to competition." 1/ Nearly two years after the Act's

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1/ Joint Statement of Managers, S. Conf. Rep. No. 104-230, 104th Cong., 2d Sess. 1 (1996) ("Conference Report"). As this Commission has stated, "[t]he fundamental objective of the 1996 Act is to bring to consumers of telecommunications services in all markets the full benefits of vigorous competition" through "'[t]he opening of all telecommunications markets to all providers [which] will ... bring new packages of services, lower prices, and increased innovation to American consumers.'" *Implementation of the Non-Accounting Safeguards of Sections 271 and 272 of the Communications Act, as amended*, First Report and Order and Further Notice of Proposed Rulemaking, CC Docket No. 96-149, 11 FCC Rcd 21905, 21911, para. 7 (1996) ("*Non-Accounting Safeguards Order*"), Order on Reconsideration, FCC 97-52 (rel. Feb. 19, 1997); Second Order on Reconsideration, 12 FCC Rcd 8653 (1997), *petition for review denied sub. nom., Bell Atlantic v. FCC*, No. 97-1432 (D.C. Cir. decided Dec. 23, 1997); *petition for review pending sub. nom. SBC Communications v. FCC*, No. 97-1118 (D.C. Cir. filed March 6, 1997) (held in abeyance pursuant to court order filed May 7, 1997).

passage, however, one conclusion is inescapable: its promise of local competition has not been realized. And as a result, RBOCs have not earned the right to provide interLATA service either. 2/

The absence of residential competition in the local market is a particular disappointment, especially for a company such as LCI International Telecom Corp. (LCI) that has made the residential market an important focus of its business. A significant portion of LCI's gross revenue is derived from service to residential subscribers, and they are a critical focus of LCI's business. LCI competes for those subscribers by providing superior service at competitive prices over advanced network facilities, primarily its own. For example, LCI has benefited consumers by pioneering innovative flat rate pricing plans (now widely copied in the industry). We recently became the first carrier to offer residential customers exact billing rounded to the nearest second, not the next minute.

LCI is committed to compete in the local market, including extending new local service choices to its millions of residential subscribers. To do so, we inevitably must make use of the ubiquitous network facilities of the ILECs, the only facilities that reach out to every subscriber in the nation.

Unfortunately, however, to date we have met only frustrating obstacles, especially in the three key areas of: (i) operations support systems (OSS); (ii) availability of unbundled network element (UNEs); and (iii) pricing. LCI has concluded that these problems are not transitional because they stem from an inherent conflict of interest between an RBOC's dual role as both network supplier and service provider. Any incentive the RBOC might have to sell the use of its

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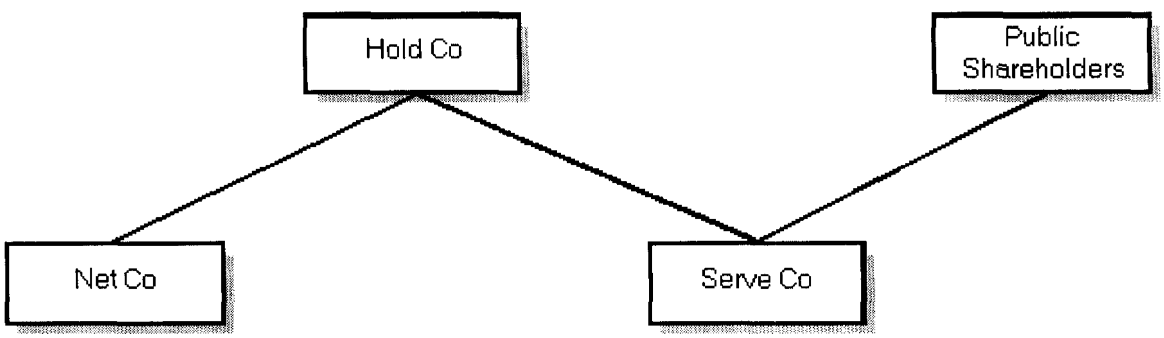
2/ Illustratively: (i) this Commission, the states and the courts are embroiled in thousands of disputes over highly complex technical, operational and pricing issues; (ii) residential consumers have no material local exchange service choice as demonstrated by the fact that RBOCs still serve virtually 100% of the residential market in their regions; (iii) local service choices for business customers is almost as sparse; (iv) RBOCs are not vigorously entering each other's local exchange markets; and (v) no RBOC to date has been able to meet the OSS requirements that were subject to this Commission's January 1, 1997 deadline.

local facilities network efficiently to CLECs is stunted by the fact that, in doing so, the RBOC's retail operations will lose customers and revenue. 3/

This petition of LCI, together with the companion petitions filed by LCI in New York and Illinois, present a way to break the logjam and jump-start more active retail -- and especially residential -- competition by creating a path (herein called "Fast Track") by which RBOCs voluntarily can reduce these conflicts of interest. Specifically, LCI proposes a corporate structure that would separate the retail and wholesale activities of the RBOC Holding Company ("HoldCo") into two separate subsidiaries. The retail company ("ServeCo") would have substantial public ownership and independent management. ServeCo would interact with the wholesale company ("NetCo") on the same arm's length, non-discriminatory basis, as any other retail service provider.



RBOCs choosing this voluntary, alternative "Fast Track" would be able to enter the interLATA market more quickly based on rebuttable presumptions of Section 271 compliance. And

3/ These problems have implications both before and after interLATA entry. Today, the impediments to local competition are preventing the RBOCs from meeting the conditions for interLATA entry specified in Section 271. But even after a Section 271 petition is approved, under the current framework these same conflicts of interest will remain and hence, absent signified structural separation, the FCC and state commissions will need to engage in significant regulation to ensure that the RBOCs do not use their monopoly control of the only ubiquitous wireline network to perpetuate their retail services monopoly.

thereafter ServeCo would be regulated like a Competitive Local Exchange Carrier ("CLEC"), without the restrictions and level of oversight that otherwise would be necessary.

This proposal is fully consistent with the Act (indeed, none of the requirements or standards of the Act are altered in any way). It also preserves the central role of the states in supervising local telecommunications. LCI is filing related petitions with the Illinois Commerce Commission ("ICC") and the New York Public Service Commission ("NYPSC") asking them to open their own proceedings to implement the "Fast Track" approach. We encourage other states to do so as well. In that regard, we note that the LCI plan does not limit the ability of the states to take other actions to promote local competition, or to protect their consumers with measures suited to their local situation.

Such proceedings already are necessary in the states. Existing state regulatory policies will need revision to accommodate the watershed event of interLATA RBOC entry. Moreover, states will need to consider additional measures to break down barriers to residential competition. LCI is asking the ICC and the NYPSC -- and by extension all states -- to recognize that residential competition can be fostered, and post-271 regulation can be much less extensive, if RBOC retail and wholesale operations are structured independently as we propose. Consistent with our desire to break the current stalemate quickly, we are asking the ICC and the NYPSC immediately to open proceedings to: (a) consider the intrastate changes necessary to implement the LCI separation plan, (b) investigate how RBOC interLATA entry will impact, and require modification of, existing regulatory processes, and (c) explore additional actions that can reduce barriers to residential competition. 4/ These proceedings are similar to those under way in many states to promote competition in the electric utility industry.

4/ LCI is filing petitions in New York and Illinois because these two states were among the first to begin the process of attempting to create local telephone competition. However, we fully recognize the major efforts of many other state commissions to create meaningful local competition, and encourage them to pursue the same solution to the current stalemate.

If adopted, the LCI "Fast Track" proposal would promote vigorous retail competition by all telecommunications providers, across all telecommunications services, for residential as well as business customers, in all areas of the country, with the least regulation possible—and would do so quickly. Indeed, if adopted, it is reasonable to believe that fully open and unrestricted retail residential and commercial competition could begin in some states by the end of 1998. By this we mean both local service competition from companies such as LCI, and interLATA service by the RBOCs.

These matters are discussed fully below. LCI explains the conflicts of interest that create the current stalemate. We present our detailed plan to reduce those conflicts in a way that would permit expedited interLATA authorizations and reduced RBOC regulation thereafter. We demonstrate the many benefits of the "Fast Track" approach, and its full consistency with the Communications Act, including the 1996 Telecom Act. Finally, we summarize how the key role of the states is preserved and enhanced by this plan. We urge the Commission to move swiftly to grant the declaratory rulings necessary to implement "Fast Track," and thereby bring the benefits of competition to local residential consumers.

I. THE SOURCES OF STALEMATE.

A. Three Critical Barriers.

Section 251(c)(3) imposes an express set of obligations on RBOCs to open their networks to other providers on non-discriminatory terms. Congress recognized that local telephone competitors could not offer adequate service without using the ubiquitous RBOC network on the same terms enjoyed by the RBOC itself. 5/ The Act thus required RBOCs to take on this wholesale "carrier's carrier" function.

5/ 47 U.S.C. § 251(c)(3); *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, First Report and Order*, CC Docket 96-98, 11 FCC Rcd 15499, 15510, paras. 14-15 (1996) ("*Local Competition Order*"), *aff'd in part and rev'd in part, sub nom. Competitive Telecommunications Ass'n v. FCC*, 117 F.3d 1068 (8th Cir. 1997); *Iowa*

In practice, however, the mandate of the Act remains unfulfilled. The lack of RBOC compliance with Section 251 has prevented full scale local competition, especially in the residential market. A brief summary of three critical barriers raised by RBOCs to date provides a key to understanding how they would be resolved through LCI's proposal.

1. The OSS Barrier.

The FCC recognized in its *Local Competition Order* that nondiscriminatory access to operations support systems was "vital to creating opportunities for meaningful competition," and that it was an "absolutely necessary" prerequisite to full-scale competition in the local market. 6/ The Commission established a January 1, 1997 deadline for RBOCs to meet this requirement, 7/ but none has done so even a year later. As the Commission well knows, LCI has a petition pending in which we demonstrate overwhelmingly the need for OSS performance standards, measurements, and remedial provisions. 8/ LCI continues to urge immediate Commission action on that petition.

The fundamental problem in OSS parity is that the RBOCs use internal, well-established OSS to provision their own customers, while CLEC competitors must use new, fragile, slow and

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Util. Bd. v. FCC, as amended on rehearing Oct. 14, 1997, 120 F.3d 753 (8th Cir. 1997), *cert. pending, citing* Conference Report at 121.

6/ *Local Competition Order*, 11 FCC Rcd at 15764, 15766, paras. 518, 521, 523.

7/ *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, Second Order on Reconsideration, CC Docket 96-98, 11 FCC Rcd 19738, 19742-44, para. 9 (1996).

8/ See *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996*, CC Docket No. 96-98, Petition for Expedited Rulemaking of LCI and the Competitive Telecommunications Association (filed May 30, 1997) ("LCI Petition"). The LCI Petition set out the extensive evidence of the problems faced by CLECs in obtaining nondiscriminatory access to OSS, including: excessive manual intervention; lack of standard processes and interfaces; significant delays in processing customer orders and providing billing information; and substantial limitations in systems for maintenance and repair. These problems were confirmed by and expanded on through the more than fifty filings by other CLECs, state commissions and users.

still largely manual OSS interfaces. The difficulty in measuring "parity" between two wholly different and fundamentally unequal systems is what drives the need for the most detailed and extensive performance standards. Until such standards are adopted and met, measuring "parity" will continue to involve largely swapping horror stories about OSS.

Furthermore, the current OSS issues threaten to be just the tip of the iceberg. Today's problem is to get some kind of satisfactory order processing system in place. But in the future the discrimination problem will become more subtle. The Commission will need to be sure that order processing continues to be equivalent for the retail operations of both the RBOCs and competitors. But the Commission also will face new issues related to billing information, maintenance and repair, and other "customer care" activities central to the wholesale function. Thus, RBOC incentives for anticompetitive discrimination will not go away, while opportunities to discriminate will expand exponentially beyond the specific OSS issues being debated today.

2. The UNE Barrier.

A second source of stalemate has been the unwillingness of RBOCs to provide UNEs in the manner requested by the CLECs, and on the same terms as they provision their own retail operations. Given LCI's large residential customer focus, we have been particularly frustrated by the RBOCs' response to requests for the so-called network element "platform" configuration. It is widely accepted (at least outside the RBOC community) that the ability to use UNEs efficiently in combination is crucial to widespread local service competition, especially for residential consumers.

The FCC has found 9/, and the Eighth Circuit affirmed 10/, that requesting carriers have the right to purchase all of the UNEs needed to provide local service, and to operate them in a

9/ *Local Competition Order* at 15666-71; paras. 328-41; *accord Access Charge Reform, Price Cap Performance Review for Local Exchange Carriers, Transport Rate Structure and Pricing, End User Common Line Charges*, First Report and Order, 7 C.R. 1209, FCC 97-158, CC Docket Nos. 96-262, 94-1, 91-213, 95-72 (rel. May 16, 1997), at paras. 32, 337 ("*Access Charge Reform Order*"), *modified in other respects* Errata (rel. June 4, 1997); Order on Reconsideration, 12 FCC Rcd 10119 (1997); Second Order on Reconsideration and Memorandum Opinion and Order, FCC 97-368, CC Docket Nos. 96-262, 94-1, 91-213 (rel. Oct.

platform configuration. The remaining issue is whether the RBOCs will prevent efficient platform-based competition pursuant to Section 251. Here, the stalemate is most obvious. RBOCs are not only refusing to "do the combining" on cost-based terms, but also announcing that they will "uncombine" preexisting element configurations serving a customer location when that customer selects an alternative local service provider. RBOCs are artificially insisting that when competitors order network elements, those elements must be physically disconnected and then reconnected by the CLEC, creating unnecessary costs and delays, and substantially increasing the risk of service outages. For example, some RBOCs are proposing to require CLECs to go to the unnecessary expense of collocating in every central office in which they seek to combine network elements. 11/ Significantly, the RBOCs are imposing these costs and burdens only on their competitors; the same disruptive processes will not apply to their own retail services.

LCI submits that these RBOC activities violate the requirements of Section 251, which clearly prohibit ILECs from interfering with the CLECs' ability to combine elements efficiently themselves, and which guarantees CLECs non-discriminatory access to the RBOC facilities to do so. 12/ For present purposes, however, what is relevant is that the RBOCs are not voluntarily

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9, 1997); *petitions for review pending sub nom. Southwestern Bell Tel. Co. v. FCC*, No. 97-2618 (and consolidated cases) (8th Cir., filed June 16, 1997).

10/ *Iowa Utilities Bd.*, 120 F.3d at 813.

11/ *See, e.g., Application of BellSouth Corp. Pursuant to Section 271*, CC Docket No. 97-208, FCC 97-418 (rel. Dec. 24, 1997) at para. 190 (BellSouth requirement that a CLEC employ collocation in order to combine loops and switching); "Bell Atlantic-New York Product Offerings: A Guide to Enabling Competitive Local Exchange Carriers to Combine Unbundled Network Elements," Nov. 13, 1997 (Bell Atlantic requirement that CLECs establish a physical presence in the central office to connect elements there). Compounding the problem is Ameritech's refusal (and perhaps the refusal of other RBOCs) to provide shared transport, even after the FCC affirmed its conclusion that shared transport was an unbundled element that must be provided under Section 251(c)(3).

12/ Unfortunately, the Eighth Circuit has held that ILECs are not required to provide access to existing element combinations. LCI believes that the Eighth Circuit's decision was wrong and acting like vendors in a competitive market. The RBOCs are refusing to give the CLECs what those carriers say they need to provide local service -- especially to residential customers: the ability to use cost-based network elements in a connected form to quickly and reliably convert and then service customer locations (selling those end users their local service, and selling other carriers exchange access and termination to such end users).

Pointedly, it is useful to consider how different the RBOCs' actions are from those one would expect if their primary focus were to provide local network elements, and if they did so in competition with other network vendors. In that event, the negotiation process contemplated by Section 252 almost certainly would work much more smoothly. An independent wholesale vendor has incentives to negotiate fairly with its customer, and to resolve contractual issues quickly on a "win-win" basis so that the vendor can sell its wholesale product, and the customer can use that product in its business. Section 252 was intended to create that market dynamic, with an arbitration process as a safety net. But the enormous number of disputes over interconnection clearly demonstrate that the 252 negotiation process is not working as intended.

Similarly, if the RBOCs' primary function were to provide network elements, and if they faced competition in that role, the RBOCs could be expected to go out of their way to meet carrier-customer requests. In such a world, the RBOCs would not be taking the step of artificially breaking up existing configurations to force their carrier-customers to put them back together. 13/ Rather, the RBOCs would be trying to help their carrier-customers by selling

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will be reversed by the Supreme Court. But the UNE stalemate will not end when the Supreme Court rules on this issue. RBOCs still will have a continuing incentive to find ways to discriminate in the provision of UNEs to their retail service competitors. If the Court reverses, RBOCs may acknowledge their obligation to combine elements (and just as importantly, the prohibition on disrupting elements that already are combined), yet still refuse to do so efficiently for their competitors. If the Court agrees that CLECs must do the combining, RBOCs likely will continue to impose barriers that make this legal option impossible in practice. Either way, the result would be the same: competing carriers would be denied efficient use of UNEs in the form they require.

13/ In complete contrast, when the RBOCs go to satisfy their interLATA network requirements, they meet no similar obstacles. Quite the contrary, in their competition to get the existing combinations where requested, and by voluntarily combining elements to create new configurations upon request. Today, however, RBOCs reserve this treatment for themselves, and meet the business needs of their competitors only to the extent that regulators eventually force them to do so.

3. The Pricing Barrier.

Sections 251 and 252 of the Act require the RBOCs to price at cost and on a nondiscriminatory basis. 14/ There is a substantial overlap between these obligations -- and enforcement of these obligations -- in an environment of mixed wholesale and retail operations. The only way to assure non-discrimination in the prices charged by the RBOC to its rivals is to assure that they are cost-based. Unfortunately, this process is difficult and complex at best, particularly in an environment where the RBOC has every incentive to hide discrimination in favor of its own retail services through, for example, inaccurate cost studies.

LCI strongly agrees that the RBOCs must be required to set their prices for UNEs and other network inputs at cost, that is, at TELRIC. Cost-based rates are critical both to permit competition to proceed over the ubiquitous RBOC network today, and to create conditions for efficient interconnection of competing network facilities as they are deployed. Only then will CLECs be using the RBOC network at rates equivalent to the internal cost of the RBOC to use those same inputs itself. Furthermore, only economically efficient network prices will provide the maximum benefits to consumers and send appropriate signals as to where, and when, companies should make facilities investments.

In addition, competition in the local market will be impossible if RBOCs are able to charge their retail competitors higher rates for wholesale inputs than the internal cost reflected in the RBOCs' own retail operations. This is true whether the discrimination comes in the form of

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RBOCs' business, operators of interLATA networks compete vigorously to offer both lower prices and the network configurations that the RBOCs desire.

14/ *See* 47 U.S.C. § 252(d).

excessive rates for competitors to use UNEs, excessive non-recurring UNE charges, or excessive charges for any other local network activity such as maintenance or order processing. The same would also be true if the RBOCs are able to subsidize their retail offerings with monopoly rents from the provision of facilities and service to competing carriers.

Unfortunately, the pricing issues that have arisen are complex, contentious, and appear destined never to end. RBOCs are litigating cost standards to be used in this process, but even after a standard is developed, 15/ huge resources still will be necessary to evaluate RBOC prices and enforce non-discrimination principles. Without such regulation, the RBOCs will have the power to thwart competition intended by the Act. But LCI's "Fast Track" plan should substantially lessen the level of scrutiny required.

B. The Common Thread in the Barriers: Inherent Conflicts of Interest.

A common thread links these and other barriers to local competition -- RBOC conflict of interest. An RBOC has two conflicting roles: (i) operator of the local wireline network that all carriers rely upon to provide retail services; and (ii) competitor in the retail market itself. Thus, whatever incentive an RBOC has to fulfill its statutory obligations to open its network, it has an equally strong, if not far stronger, incentive to prevent retail competitors from capturing local market share. 16/

15/ As the Department of Justice recognized, this absence of a consistently applied costing methodology creates great uncertainty regarding future prices, and hence "it is not surprising that there is no real competition using unbundled elements now, or that competitors' plans to compete in the future are subject to many contingencies." *See* DOJ SC Evaluation at 40-41.

16/ Thus, the requirements of the Act are "counterintuitive" from the perspective of the RBOCs, as was recently observed by Joel Klein, Assistant Attorney General for Antitrust of the United States Department of Justice. Klein noted that RBOCs must be held to "tough performance measures" under Section 271 because it was "counterintuitive" for them to open their networks to allow CLECs to compete with them and capture market share. *See* Communications Daily, at 2 (Dec. 12, 1997).

This inherent conflict of interest lies at the center of the problems the industry is facing in bringing local competition to consumers -- especially in the residential market. Congress recognized the problem and attempted to deal with it. Sections 271 and 272, in addition to 251(c), established specific obligations on RBOCs to make their networks available to other carriers because Congress saw that the RBOCs had no incentive to do so voluntarily. 17/

Unfortunately, however, the Commission and the states have faced huge difficulties in attempting to enforce these clear RBOC obligations -- despite the fact that today the RBOCs have the special, one-time, incentive of Section 271 interLATA entry. After such entry, regulators will be forced to monitor RBOC activity even more closely, at great expense and burden, to ensure that RBOCs do not use their control of the local network for anti-competitive ends. But the prospect of permanent regulatory vigilance only promises unending state and federal regulatory proceedings. If such regulation fails, then telecommunications consumers could find themselves doubly cursed. They could lose both their best chance for local service competition, and also the long distance competition they already enjoy.

II. LCI'S "FAST TRACK" PROPOSAL.

LCI believes the Act can work as intended, and soon -- provided that this Commission and the states adopt an alternative "Fast Track" approach to regulation that meaningfully addresses the RBOCs' inherent conflicts of interest. "Fast Track" is based on a tool that is available under the Act, and often used by the Commission in analogous circumstances—structural separation. LCI believes that adequate structural separation between an RBOC's

17/ This Commission has recognized this conflict expressly in its *Non-Accounting Safeguards Order*: "For example, a BOC may have an incentive to degrade services and facilities furnished to its affiliate's rivals, in order to deprive those rivals of efficiencies that its affiliate enjoys. Moreover, ... a BOC that discriminates against the rivals of its affiliates could entrench its position in local markets by making these rivals' offerings less attractive. ... Moreover, if a BOC charges other firms prices for inputs that are higher than the prices charged, or effectively charged, to the BOC's section 272 affiliate, then the BOC could create a 'price squeeze.' *Non-Accounting Safeguards Order*, supra, 11 FCC Rcd at 21912, para. 11.

wholesale network operations and its retail affiliate would substantially lessen the conflicts inherent when the RBOC provides inputs to competitors while competing directly with them. It therefore would simplify the process of Section 271 interLATA entry. Separation also would make reliance on post-entry regulation to control RBOC behavior less important, and therefore less intrusive, complicated, and time-consuming for all involved—the FCC, the state commissions, the RBOCs, and CLECs.

We emphasize that the "Fast Track" proposal differs fundamentally from ILEC-designed retail/wholesale separation plans (including the plans that have been implemented by Rochester Telephone ("Rochester") and Southern New England Telephone ("SNET"). These ILEC plans do not go nearly far enough to cure the conflicts of interest at the root of the current stalemate. Furthermore, the RBOCs raise competitive issues that are far more serious than those presented by smaller, geographically constrained, independent ILECs.

LCI calls its proposal "Fast Track" because it promises to achieve real local competition -- for residential as well as business consumers -- on a rapid basis. This in turn means that RBOC interLATA entry also could be accelerated safely.

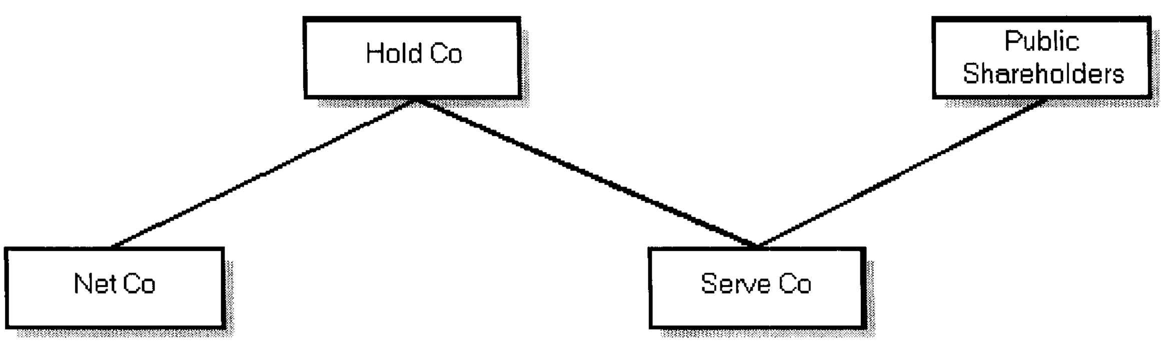
It is important to note, however, that <u>all elements of the proposal must be implemented for the RBOCs' inherent conflicts of interest to be checked sufficiently</u>. Any watering down of the minimum requirements of the plan would undo the safeguards justifying 271 entry and reduced RBOC regulation. At the same time, the "Fast Track" plan preserves the traditional ability and jurisdiction of state commissions to take any other actions to promote local competition, or to protect their consumers, as part of their own consideration of these issues. With these caveats, the details of the proposal are as follows:

A. The Substance of the Proposal.

1. The Proposal in General.

LCI proposes that the Commission adopt an optional "Fast Track" path which the RBOCs may, but are not required to, employ. Specifically, LCI proposes that the Commission set forth a wholesale/retail corporate structure that, if implemented by an RBOC, could justify a rebuttable presumption of compliance with Section 271 and obtain reduced regulation rapidly. The RBOCs would separate completely their retail and wholesale activities. The RBOC holding company ("HoldCo") would establish a retail service company ("ServeCo") separate from its existing local network operations ("NetCo"). Under this plan, the RBOC would remain a telecommunications provider fully subject to all provisions of the Act. The RBOC's retail local and long distance telecommunications service activities would be housed in ServeCo, while NetCo would manage the local network and sell it on a "carrier's carrier" basis to all retailers, including ServeCo, interfacing with every retail service provider on the same basis using the same personnel and systems.

Importantly, ServeCo would have incentives and fiduciary duties separate from HoldCo and NetCo. ServeCo would have partial public ownership independent of HoldCo, independent directors representing the public shareholders, and independent management compensated entirely based on ServeCo's financial performance.



All new retail customers would be provided service through ServeCo or other CLECs. On a transitional basis, NetCo would continue to serve the existing RBOC local customer base. However, NetCo would not be permitted to add customers, nor would it be permitted to add new retail services or actively market retail services to that base. ServeCo would have to compete for, win over, and assume all retail responsibility for a NetCo local customer in competition with other CLECs in order to provide that customer with interLATA long distance. NetCo thus would lose its retail local subscribers over time to ServeCo and others. State commissions could decide whether and at what point it is appropriate to transition all residual local customers out of NetCo through balloting and allocation, making NetCo a "pure" wholesale company.

The "Fast Track" proposal is fundamentally different from any of the retail/wholesale plans that have been implemented or proposed by ILECs. The SNET plan, for example, provides for the eventual elimination of the network company's retail activities, but it does not require the retail company to use the same OSS that CLECs must use. 18/ The SNET plan also does not provide for public ownership or other indicia of independence in the retail company, nor does it require full separation of the two companies. The Rochester plan suffers from these same defects, and in addition, does not require that the retail base of the network company ever be competed or balloted away. 19/ GTE and BellSouth, among other ILECs, have sought authority

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18/ *DPUC Investigation of the Southern New England Telephone Co. Affiliate Matters Associated with the Implementation of Public Act 94-83, Decision*, Docket No. 94-10-05 (CT Dept. of Pub. Util. Control June 25, 1997) ("*SNET Affiliate Initial Decision*"), modified by Decisions dated Sep. 10, 1997; Oct. 8, 1997; Oct. 28, 1997; and Dec. 22, 1997. The SNET plan also provided for balloting and allocation to begin shortly after the restructure took place. The Connecticut DPUC recently ordered that balloting be moved back by at least a year, citing inadequacies in the OSS systems for both SNET and the CLECs. *SNET Affiliate Decision Delaying Elements of the Transition* (Dec. 22, 1997) at 2, 5-6. The DPUC also required that balloting not take place until SNET had demonstrated parity between the OSS systems used by its retail affiliate and those used by CLECs. Id.

19/ *Petition of Rochester Telephone Corp. for Approval of Proposed Restructuring Plan, Opinion and Order Approving Joint Stipulation and Agreement*, Case Nos. 93-C-0103, 93-C-0033, Opinion No. 94-25 (NY Pub. Serv. Comm'n. Nov. 10, 1994) ("*Rochester Order*;" "*Rochester Joint Stipulation and Agreement*").

to offer local exchange services in competition with their own network company in their service areas, but these proposals offer nothing to ensure that the ILEC's CLEC affiliate will be independent from the ILEC. In fact, all these proposals are simply thinly disguised attempts to move selected local exchange retail activity into an unregulated subsidiary (exempt, they claim from Section 251(c) obligations that otherwise would apply). These ILEC plans do nothing to address the core incentives and ability of the parent holding company to manipulate the subsidiaries in ways that discriminate against CLECs. 20/

In short, the mere separation of retail and wholesale activity does not cure the ILECs' underlying conflicts of interest. 21/ In the sections that follow, LCI first sets forth the specific details of its proposal which address these conflicts. We then explain how these elements collectively satisfy the seven minimum criteria for adequate separation of RBOC wholesale and

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20/ See, *e.g.*, *Application of GTE Communications Corp. for a Certificate of Operating Authority in SWBT, Sprint/United and Centel Service Territories*, Order, Docket No. 18146 (TX Pub. Util. Comm'n Oct. 30, 1997) ("*GTE CLEC Certification Order*") (denying GTE a CLEC certificate in its local service area); *Application for Certificate to Provide Alternative Local Exchange Telecommunications Service by BellSouth BSE, Inc.*, Order Granting Certificate, Docket No. 971056-TX, Order No. PSC-97-1347-FOF-WS (FL Pub. Serv. Comm'n Issued Oct. 27, 1997) ("*FL BellSouth Certification Order*"), *petitions for administrative hearing granted* (Order Establishing Procedure, Jan. 14, 1998) (setting BellSouth's CLEC application for hearing); *Application of BellSouth BSE, Inc. for Certificate of Public Convenience and Necessity to Provide Local Exchange Services in the State of South Carolina*, Order Approving Certificate, December 23, 1997 (granting BellSouth's CLEC certificate). Opponents to these proposals have correctly argued that simply moving an ILEC's retail activities into a separate affiliate is not a basis for exempting those activities from Section 251(c) and other requirements applicable to incumbent LECs.

21/ LCI's plan also differs from the Section 272 model for the separate interLATA affiliate because it goes beyond Section 272 in that the RBOCs would voluntarily agree that *all* retail services will be provided through that affiliate (except for the embedded base) and because it gives that affiliate other indicia of true independence (such as outside public ownership and management compensation tied solely to the affiliate's performance). Unlike the Section 272 affiliate, ServeCo would have incentives to act as if it were an independent CLEC, and not just another self-dealing arm of the RBOC.

retail activity. Because the "Fast Track" plan contains all the "seven minimums," it would unlock the door to residential local competition and Section 271 entry. 22/

2. LCI's Proposal in Detail.

a. The Corporate Structure.

(i) Separation of NetCo from ServeCo would be absolute, other than the parent HoldCo's partial ownership in ServeCo. ServeCo would not share officers, directors, personnel, equipment, buildings, services, or other resources with HoldCo or NetCo (or any affiliate of those entities).

(ii) ServeCo would have sufficient minority public ownership (in the range of 40% or more) to ensure that it has a significant fiduciary obligation other than to HoldCo. Because its shares would be owned and publicly traded by persons or institutions expecting to earn profits from ServeCo's operations without regard to ServeCo's affiliation with HoldCo or NetCo, market pressures would help give the retail affiliate stronger incentives to earn a reasonable return on investments. ServeCo also would have independent reporting requirements under the securities laws, and would be subject to suits from its public shareholders if operated in a way that unduly advantages HoldCo (or any of HoldCo's affiliates, including NetCo).

(iii) ServeCo would have independent board members specifically charged with representing the interests of the public shareholders. 23/

22/ At the same time, the "Fast Track" plan preserves the ability of state commissions to take other actions to promote local competition or to protect their consumers with measures particularly suited to their local situations.

23/ By "independent director" we mean a director who has no financial interest in NetCo or HoldCo (including stock ownership), has no employment or consultant relationship (past or present) with NetCo, HoldCo, or any other HoldCo affiliate, and has no other present or past business or professional relationship with NetCo, HoldCo, or any HoldCo affiliate that could affect her independent judgment.

(iv) Compensation of ServeCo management (including bonuses and stock options) would be tied only to the financial success of ServeCo, not to the success of HoldCo (or any other HoldCo affiliate). Stock options would be awarded only in ServeCo stock.

(v) Section 272 separation requirements would apply, including FCC-prescribed accounting and non-accounting safeguards. 24/

b. Role of NetCo.

(i) NetCo would own and operate the existing RBOC local exchange network, and would be required to make that network and related operational support available equally to ServeCo and all CLECs. 25/

(ii) NetCo's embedded base of customers would be assigned to competing CLECs (including ServeCo) through balloting and allocation at a time to be determined by state utility commissions.

(iii) To avoid disruption to the embedded base of existing local customers, NetCo would continue to provide them with retail local exchange and intraLATA telephone service during the transition period prior to balloting. However, NetCo could not accept any new customers (including existing customers who physically move within the local area).

24/ These requirements would apply to transactions and other arrangements between ServeCo and either HoldCo, NetCo or their affiliates.

25/ NetCo shall retain all facilities, systems, information, licenses, other intellectual property rights, and other assets used in connection with, or otherwise relating to, the provision of interconnection, network elements, and exchange, exchange access, and intraLATA toll telecommunications services, including all pre-ordering, ordering, provisioning, maintenance and repair, billing and collection, and other operations support system, customer care, and associated functions. None of these assets and capabilities would be transferred upon restructure to ServeCo. To the extent NetCo thereafter provides these assets and capabilities to ServeCo, it would do so only on the same terms and conditions upon which the assets and capabilities are made available to any other carrier.

(iv) NetCo's retail tariff would be frozen. Existing NetCo customers would be able to add a feature from the tariff in effect at the date of implementation. However, new retail products would be provided by ServeCo, not NetCo.

(v) NetCo would be precluded from engaging in any retail marketing, even to its embedded base of local exchange customers or to others.

(vi) NetCo would provide interconnection and network elements, as well as meet the other obligations of Sections 251 and 252. During the transition period prior to allocation, NetCo also would provide wholesale versions of its retail local and intraLATA telecommunications services for resale, and exchange access to CLECs needing to reach the existing customer base.

(vii) NetCo would be obligated to provide combinations of network elements on a prompt and efficient basis reflective of its actual cost. NetCo would be prohibited from disrupting network element combinations, except at the request of the CLEC.

(viii) NetCo could expand and enhance the local network as it deemed appropriate in its business judgment, and on a non-discriminatory basis, to meet the needs of carrier-customers, including ServeCo.

(ix) NetCo would be precluded from transferring local network facilities to ServeCo.

c. Role of ServeCo.

(i) ServeCo would be allowed to offer all the services of a CLEC. Thus, ServeCo could offer any retail service to any end user. ServeCo also would offer exchange access and interconnection to other carriers who need to originate or terminate traffic to a ServeCo end user.

(ii) During the transition period prior to balloting and allocation, ServeCo would not be allowed to provide interLATA service to NetCo customers until and unless NetCo's OSS systems to provision and support network element combinations are capable of processing the same volumes of customer transfers, at the same intervals, as the PIC-change systems used to process long distance customer transfers. 26/ No other restrictions would apply to ServeCo's retail operations. Thus, ServeCo could sell both local and interLATA service to NetCo customers, in which event their local service would be switched to ServeCo using the same OSS and carrier's carrier network offerings as used by other CLECs. ServeCo also could sell stand-alone interLATA service to any customers previously switched to another CLEC.

(iii) ServeCo would be the Section 272 interLATA affiliate. Unless it met the same level of separation, no other RBOC affiliate could provide retail local exchange service or interLATA services.

(iv) ServeCo would not bear the obligations of an ILEC under Sections 251 and 252, though these obligations would continue to apply to HoldCo and its wholly-owned subsidiary, NetCo (as well as successors and assigns of those entities).

(v) ServeCo would be free to buy network inputs from other carriers besides NetCo. It also could build its own network, just as other CLECs may.

d. Nondiscrimination.

(i) ServeCo would interface with NetCo in exactly the same manner as other CLECs do. ServeCo would need to switch every local customer that it wins from NetCo, just as any other CLEC would, using the same OSS interfaces, and would purchase wholesale inputs from NetCo at the same rates, terms, and conditions as

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26/ This transitional restriction would erode in relevance as NetCo loses customers in the ordinary course, and would disappear once OSS systems supporting network element combinations are comparable to the PIC-change process.

other CLECs. NetCo would not be permitted to develop or use any interfaces or OSS equipment with ServeCo that are not also available to other CLECs.

(ii) NetCo could not treat ServeCo any differently than any other CLEC (e.g., no endorsement or other recommendation of ServeCo; no transfer of customer calls to ServeCo unless pursuant to identical and nondiscriminatory terms, conditions, procedures and practices that would apply for every other carrier, etc.). NetCo also would have to follow nondiscriminatory procedures for handling inquiries from its embedded customer base regarding available providers for local, long distance, or other service, without mentioning its affiliate except as part of a larger random list.

(iii) NetCo may provide wholesale facilities and services to ServeCo only under published tariffs. If interconnection agreements are entered into between ServeCo and NetCo, they must be documented in tariffs and subject to a "pick-and-choose" rule. 27/

(iv) ServeCo may have access to and use information about NetCo's customers only pursuant to the FCC's CPNI regulations, and only if other carriers can obtain the same information on the same terms and conditions. ServeCo may not take with it any such information, or other ILEC asset, upon separation.

(v) To avoid customer confusion, NetCo and ServeCo must operate under materially different trade names and service marks that do not reflect any affiliation. For example, HoldCo may allow either NetCo or ServeCo to use HoldCo's name, but not both.

27/ We recognize that the FCC may not currently be able to order "pick-and-choose." Rather, this would be a necessary condition of our voluntary structural separation proposal.